# SOME ASPECTS OF GOVERNMENT CONTROL OVER APPOINTMENT OF COMPANY DIRECTORS

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Under the Indian Companies Act Central government has assumed very wide and far reaching powers over the terms of appointment of managing and wholetime directors and managers in pubilc companies and private companies which are subsidiary to public companies, and also in fixing up their remunerations. The *raison d'etre* for such a degree of control, different in both quantity and quality from the control which company law anywhere else in the world exercises, is that, first, the management of public companies does not pass into the hands of undersirable persons, and secondly, that the managerial personnel do not claim for themselves a share of the company's profit disproportionate to the contribution they have actually made, and also to the return which the members of the company are getting on their investment. An attempt has been made by means of some 293 provisicns in the companies Act, 1956 to transfer the ultimate authority to the shareholders, and to vest effective authority in day-to-day matters in their elected representatives, *viz.* the directors to whom the various managerial agencies envisaged in the Act, namely, managing director, managing agents, manager, and secretaries and treasurers, have been subordinated. Also standing as the essential back-drop behind many of these regulations is the rather amorphous but well understood concept of public interest which justifies intervention by public authorities in private business in a wide variety of circumstances.

## The Guidelines

The Companies Act seeks to ensure that the mangement of public companies and private companies subsidiary to public companies remain in the hands of the right kind of people. Thus, sections 269 and 387 lay down that the appointment of managing directors, whole-time directors and managers should be made by the company only with the approval of the Central government. It automatically follows that such appointment will be invalid if the Government refuses to approve. Now this power to approve or refuse is a very wide discretionary power conferred by the Act. But apart from the indirect guide-line provided by section 274 which

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lays down various disqualifications for appointment as company director the Act does not indicate any criteria on the basis of which government is to decide what types of people should be approved as managing director, whole-time director or manager, or what types of people should be disapproved. This appears to be in contrast to the corresponding provision with regard to appointment of managing agents, *viz.* section 326 (2). This section says that the Central government should not accord its approval to the appointment of managing agents unless it is satisfied :

(*a*) that it is not against public interest to allow the company to have a managing agent ;

(*b*) that the proposed managing agent is a fit and proper person to be appointed ; and that conditions of the managing agency agreement proposed are fair and reasonable ; and

(*c*) that the managing agent proposed has fulfilled any conditions which the Central government requires him to fulfil.

The absence of any such criteria in sections 269 and 388 of the Act must be considered an important gap which is likely to be emphasised as more and more companies switch on from managing agency to management by managing directors or board of directors or managers. It would appear that framers of the Act were pre-occupied with the object of putting the institution of managing agency under firm public control and left other forms of management comparatively untouched in their details. With the impending abolition of managing agency, the context has now changed, and there seems to be a case for inserting in sections 269 and 388 some provisions on the lines of section 326 (2) in substance at least, even if not in such rigorous manner. This will provide before the administrators of the Act some guiding line to determine the circumstances under which approval should be granted and those under which it should not be. It is difficult to disagree with the view expressed by C.A.R. Crossland in his book 'Future of Socialism' that "the State's relations with its citizens should be regulated by the law, so that everyone knows where he stands, and what behaviour is reprehensible and what is not, and not by a system of Government agents with no fixed terms of reference, and hence inevitably arbitrary in their decisions."

**Lacunal**

What is indicated above is also part of a very general question. The present Act seems to have directed most of its fire on the known and widely criticised malpractices connected with managing agents. There are some fifty four sections of the Act restricting the activities of managing agents. Now that the die is cast, and this institution is likely to be a part of history very soon, it has to be determined whether there is scope for the reappearance of some of these malpractices even within the framework of the other permissible forms of management. To take an instance, the Act has introduced a new concept, that of an 'associate' of managing agent which is broadly defined as a relative or business associate including partners and companies. The purpose of this concept is to prevent evasion of certain prohibited acts through an associate. Thus, the Act contains a number of restrictive provisions directed against the managing agents and also their associates wherever appropriate. It should be considered if the definition of 'associate' in relation to an individual managing agent should be made applicable to directors and managers also. There are several other provisions applicable in the present Act only to the manging agents which could very well be applied to other forms of management.

Another well-known lacuna in the pattern of government control over board of directors is in regard to the position of whole-time directors. Nowhere in the Act is this term defined. And yet many sections mention this bracketing it with managing directors specially with regard to their appointment and remuneration and the need for government approval to both. For all practical purposes, a whole-time director is considered indistinguishable from the managing director. And yet section 197 A does not include whole-time directors in the category of managerial personnel. Thus, under law and in practice, it is quite permissible for even a managed company to have whole-time directors. This could not perhaps have been the intention of the framers of the Act. Similarly section 316 does not specifically restrict the number of companies in which one person can serve as whole-time director. Although by an interpretation of the expression "whole-time director" no one should be allowed to be whole-time director of more than one company, the absence of a specific provision as in the case of a managing director must be considered a loophole in the general scheme of things. Similarly, section 317, which says that a managing director cannot be appointed for any period more than five years, does not include whole-time directors within its ambit. This is also an important omission. Once a whole-time director is appointed with Central government's approval, the company seems to have absolute right to continue him in its employment *ad infinitum*. With the growing tendency among some large public companies, in which management is becoming highly professionalised, to prefer management by board of directors with the help of several whole-time directors. these points required to be tied up in the Act.

Another tendency noticed in the recent years is that some companies have gone for actual day-to-day management by a committee of directors rather than by a managing director or managing agent, under the overall supervision of the *board of directors*. This practice is not provided for in the Indian Companies Act anywhere. It is of course arguable that insofar as the members of such a committee of directors have substantial powers of management vested in them, everyone of them should be deemed to be a director under the Act. Does this view correspond with the reality of the situation ? Or will it not be more correct to say that the position of such a committee of directors *vis-a-vis* the company's *board of directors* is analogous to the distinction drawn from a very long time in German corporation law between a company's *executive board* and the *supervisory board* ? It is relevant to mention that in the German system the *executive board* is appointed and supervised by the *supervisory board* and that managerial decisions cannot be assigned to the latter body and are primarily the responsibility of the members of the *executive board*. The legal position of such a committee of directors, as prevalent in some Indian companies, should be carefully examined, and necessary provision should also be made in the Act, if we have to make company management more flexible and forward-looking.

**Remuneration of Managerial Personnel**

The provisions the Indian Companies Act relating to remuneration of managerial personnel in public companies and private companies which are subsidiary to public companies are strikingly original and have also been acclaimed in company law circles in western countries. The Act lays down that the total managerial remuneration in such companies shall not exceed 11% of the company's net profits[1]. Section 309 (3) lays down that remuneration of individual managing or whole-time director should not exceed 5% of the net profits and in case a company has more than one such director, the remuneration payable to all of them together should not exceed 10% of the net profits. The part-time directors are allowed remuneration of 1% of the net profits where the company is managed by managing agent or managing director or manager, and 3% of the net profits where the company is not under any other form of management. Ever since 1959 following a pronouncement made by the then Minister of Commerce & Industry, Shri Lal Bahadur Shastri, in Parliament that "the basic principle is that no individual should be paid a remuneration exceeding Rs. 1,20,000 *per annum* or Rs. 10,000 per month" the Central government has also been following a policy of imposing an administrative ceiling on the maximum remuneration payable to an individual managing director or whole-time director in keeping with certain broad social and economic objectives in our state policy in the light of the directive principles of our constitution.

1. S. 198 Indian Companies Act 1956.

It appears that the attitude of the Central government on the administrative ceiling is flexible and that it should be relaxed normally if the facts and circumstances of the case indicated such relaxation to be justified.[2] By relating the question of managerial remuneration to the net profit of the company concerned, the Act introduced a revolutionary concept. But certain questions are raised unavoidably. The mechanical application of a uniform administrative ceiling does not seem to take into account the difference between a fairly large-sized company and a relatively small one assuming that both the companies are making enough profit to cover the salaries sanctioned for their managerial personnel.

The managing director of a company with a capital base of Rs. 10 crores and turnover of Rs.20 crores may get the same remuneration as his counter-part in another company with a capital base of Rs.2 crores and turnover of Rs.5 crores. On the other hand, a uniform administrative ceiling does not seem to provide for the elements of managerial skill and ability which are considered fairly important in modern management. Other things being equal an extremely capable managing director may have to be contented with the same pay packet as that of a relatively mediocre one in a different company. This question of incentive for efficient management, or increased profitability would seem to have assumed a lot of importance in the present context of increasing professionalisation of management on the one hand, and the prevailing recession in the field of industry and business on the other. So long as management in our country was largely hereditary and proprietary in character, there was perhaps room for uniform application of a rate of remuneration based on profit. But professional directors and managers are increasingly coming to the field of corporate management. They are basically salary earners with little or no interest in higher profit of the company apart from an element of personal satisfaction and pride. Such people cannot be retained by a company so long as a remuneration is linked up with profit and no provision is made for, first, the control of a regular monthly salary and secondly, the possibility or certainty of higher financial inducement consequent on showing larger profit and better performance. This has become all the more important in the prevailing atmosphere of our country today when managerial skill as a factor in a business concern's performance has become important as never before and the success or failure of companies very often depend on the availability of first-rate working directors at the helm of their affairs. The Act should have adequate provision for enabling such people to come in increasing number to the field of corporate management. The present provision

2. See IX and XI Annual Reports of the Department of Company Affairs, pages 24-25 and 32 respectively.

under section 198 (4) for the granting of a minimum remuneration in the event of absence or inadequacy of profits ordinarily upto a maximum of Rs. 50,000 per year altogether seems to be inadequate in meeting the requirement of a giant company. In the general scheme of the Act it is envisaged more as an exception than as a rule. It does not take into account the genuine requirement of a large-size company. It also saddles corporate management with a lot of avoidable uncertainty until the closing of the year. If we care to ensure the availability of better type of people in corporate management and a vastly improved performance on its part, some formula within the Act should be devised under which a managing director or whole-time director or manager will be assured of a reasonable and regular minimum salary based on the capital base of the company and other allied factors, and this should be coupled with a provision for commission based on the profit of the company. An overall limit should be fixed on it in accordance with the basic socio-economic policy of the State. An alternative to the commission on net profit that has been suggested is that remuneration should have a definite ratio to the amount of equity dividend declared. Such incentive will be clearly justifiable when the director, or the manager concerned has been responsible for the company's excellent working results. The tendency in some quarters to compare Indian directors' salary scales with those in western countries is not proper. Such comparison will be valid only when the difference in *per capita* income between India and those advanced countries is substantially narrowed down. Such a provision will reduce the necessity of too many references to government authorities. It will ensure overall government control over the remuneration of top personnel in corporate sectors. It will also be in tune with our government's basic social and economic objectives.

**Filling Casusal Vacancies**

Section 262 confers on the *borad of directors* in a company the power to fill in a casual vacancy in the board caused by a director appointed by the company in general meeting vacating his directorship before the expiry of his term. Under sub-section (2), the newly-appointed director in such a vacancy is to hold the office during the entire period for which the erstwhile director would have held office. This appears to curtail the authority of the members of the company to some extent. It is interesting to note that casual vacancies can sometimes occur in the board of directors in the normal course of circumstances on account of the operation of section 273. This section outlines certain additional circumstances in which the office of the director is vacated. Under this section a directorship can fall vacant in a very casual manner, *e.g.* a director taking a loan from the company in contravention of section 295, or making a contract with the company in contravention of section 299 or failing to purchase qualification shares or failing to be present at the board meeting on three consecutive occasions without leave of absence. In this context the board's power to fill vacancies under section 262 without the necessity of even subsequent approval by the members of the company, must be viewed as a lacuna in the general scheme of the Act. While the board may have the power to appoint anyone on such occasions, this should be ratified by the company in its next general meeting.

**Government Representation in Public Companies**

Should there be government directors appointed in every public company ? There is a considerable body of theory in favour of this. Eminent writers like Drucker, Albu, and Goydar have argued that government should have the right to representation on the boards of public companies. This can be done by enacting a law that in every public company. The government will be entitled to a share which will carry with it the right to nominate a director in the board of the company. The reasons in favour of this view are that investment in shares should not automatically give investors alone the sole right of control and managment and that a modern corporation is essentially a joint enterprise in which shareholders, management and workers are involved in equal degrees. This has been further accentuated because of the growing trend in the modern corporations of the West towards separation of management and ownership. The present law, which seeks to protect the legal right only of the shareholders, is highly unreal in the context of the present day realities. To protect all the interests involved and above all to safeguard public interest which is involved in a very large measure in the public companies, various western thinkers on the subject including those mentioned above have sought to advocate a more logical structure for joint stock enterprises in which all the interests involved will be represented. The enterprise law in Germany has perhaps gone utmost in this direction by providing for compulsory representation of workers in the *supervisory boards*. It is out of these considerations that the suggestion of compulsory government directors in public companies is born. The underlying object is to ensure greater public accountability. It is however felt that in India where the Companies Act went quite early in the direction of tightening government control over companies, such a proposal is likely to be a mere superfluity. There should surely be more effective ways of ensuring the public accountability than sending one or two government directors unfamiliar with the affairs of the company. It has been argued that government directors are also necessary for more effective planning control over the corporate sector. But such a view does not seem to understand that true planning is never concerned with the level of an individual company but seeks to operate as a broader influence over industry and business as a whole, or groups of industries. Even if at times planning at the level controls appear to be a better method than the doubtful control exercised by government directors scattered over the whole corporate field. The experiences of appointment of government directors under section 408 of the Companies Act in order to prevent (*i*) oppression of the minority and (*ii*) the affairs of the company from being run against the interest of the company or against public interest, are of special relevance here. Government directors in such private boards either remains 'eternal suspect' or must necessarily 'go native'. They are not able to discharge their duties properly in either event. Unless they have with them the power of vetoing decisions made by company management, they will always be outvoted wherever they differ with others on policy and will, to that extent, be ineffective. But such a veto, although strongly advocated in certain quarters, may deadlock the affairs of the company and will lead to charges of undue interference in the internal affairs of the company and fettering its business decision. In such a situation efficiency of management will surely suffer. Finally, it will be difficult for government to get so many suitable men for this type of job when we have a serious shortage of men with proved business ability coupled with progressive ideas. It will not be proper to waste such scarce talent on an objective which can be much better achieved by another means. Perhaps it will be better to wait for several years and study the effectiveness of government directors appointed in companies under section 408 before the suggestion for compulsory government director in public companies can be seriously considered.